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Greece in the deadlock of the Troika's Austerity Trap

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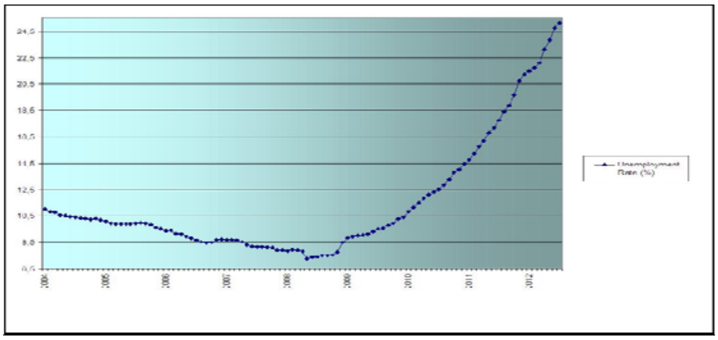
On 27 November 2012, the Eurogroup reached a new "Greek deal" which once more discloses that there is no political will to address Greece's debt crisis, as well as the country's economic and social catastrophe. This fact increasingly makes Greeks think that the sovereign debt crisis incorporates significant geo-economic and geo-political interests at the expense of national sovereignty. Nonetheless, in the pure economic domain, there are two main aspects of the new agreement: first, the Troika's condition that Greece has to adopt and apply a fiscal correction mechanism to "safeguard the achievement" of irrational and unrealistic fiscal growth and privatisation targets. This mechanism will institutionalise economic austerity and the impoverishment of Greek workers in the private and public sectors, and squeeze to zero the degrees of freedom for national economic policy-making.

The second aspect is the restructuring of creditors' debt claims as a means for Greece to reduce its financing gap and borrowing needs. This decision, in conjunction with Greece's public debt tender purchases, is hypothesised to bring Greece's public debt back on a sustainable path by 2020-2022, which will facilitate the gradual return to market financing. The new agreement between Greece and the Troika is characterised by much fantasy, but little realism. The economic, social, and political environment in Greece remains fluid since uncertainty and lack of credibility continue to surround the course of economic policy-making in Greece and the Eurozone.

In the last 20 years or so, the Greek economy has been transformed into a consumption/demand-driven growth economy, which relied heavily on debt accumulation, with significant structural deficits in the production system that steadily undermined the country's competitiveness and external position. This economic model, which does not incorporate an endogenous mechanism of sustainable income creation, is perceived by investors to have high credit risk and high margins of safety of new borrowing, especially within the current architecture of the Eurozone, where there is no "lender of last resort" institution.

Initially the global financial crisis, and then the sovereign debt crisis, induced Greece to pass through a process of de-leverage, which caused negative demand and growth effects, reducing the country's credibility and solvency in the private bond markets. Furthermore, the Troika's austerity trap, which has been enforced by the bailout agreements, has caused a considerable reduction in domestic demand, deepening the recession and minimising any possibility for restoring the country's credibility and solvency. Figure 1 shows the sharp increase in the unemployment rate and reflects the economic and social catastrophe that has taken place in Greece due to the Troika's first two Memoranda.

Figure 1: The Evolution of the Unemployment Rate in Greece, 2004-2012



Source: Hellenic Statistical Authority, Labour Force Survey, July 2012.

Furthermore, the debt structure of the Greek public sector was not sustainable before, did not become sustainable after the "haircut" in March 2012, and will not become sustainable after November 2012's Eurogroup decision. As long as the Greek debt is considered unsustainable, liquidity and solvency problems will arise, rapidly multiply, and spread to the entire economy, which will continue to evolve through a "debt-deflation" process with catastrophic employment, growth, and wealth effects, leading the country to an impasse. The current situation in Greece involves a self-defeating cycle of extremely tight fiscal and income policies and recession that subvert the country's ability to meet its debt obligations. This self-defeating cycle and the Troika's obsession with tax increases, and expenditure reductions, while the economy is already deeply depressed, keep Greece in a "default trap" that increases the country's currency risk as well as the fragility and instability of the Greek banking system.

The abovementioned factors lead to the conclusion that Greece urgently needs a new strategy. The economic rationale of this strategy must differ completely from the one embodied in the Troika's Memoranda determined by Germany's illusions, economic interests and federal political cycle. This new strategy must be implemented consistently, and without delay, in order for Greece to gear towards an exit from the economic, social, and financial crisis, and towards sustainable growth and public debt. This strategy must rely on three major pivots, given today's architecture of the Economic and Monetary Union of the European Union (EMU).

For restoring Greece's solvency and credibility, it is fundamental to create expectations that the Greek economy can generate primary surpluses that can fulfil a great deal, if not all, of its annual debt obligations. For this to happen, a new restructuring of the country's public debt is necessary. It should incorporate a substantial "haircut" of its nominal stock of debt, a close to zero interest rate and a considerable extension of the period in which Greece will have to fulfil interest and principal payment agreements. Greece's economic survival pre-supposes that the annual debt obligations fall to economically and socially affordable levels. Furthermore, the sustainability of making primary surpluses depends heavily on economic growth. Any attempt to create primary surplus in a stagnant and depressed economy through economic austerity is determined to fail, with detrimental economic and social effects, without resolving the problems of solvency and credibility.

In addition, economic austerity delays Greece's fiscal adjustment and the implementation of vital structural reforms in the production system. The reason is that it creates recession that negatively affects market expectations that the economy will exit from the "default trap", discouraging potential domestic and foreign investors. As long as the vicious circle of fiscal and income austerity recession "default trap" continues, the prospects for Greece to meet deficit and debt targets will tend to weaken, thus refuelling negative expectations. Nonetheless, the current recession and the liquidity and solvency constraints of the Greek economy do not make any shift to a more expansionary fiscal and incomes' stance feasible. Consequently, is there any institution that can stabilise the macroeconomic system and the financial system of the Greek economy in the short-term and create the conditions for the country to generate primary surpluses to meet affordable debt obligations?

My answer is affirmative, and this institution is Hyman Minsky's "Employer of Last Resort" (ELR) programs (see e.g. Minsky 1986, Papadimitriou and Minsky 1994) that are unique countercyclical government initiatives that show evidence of growth and poverty alleviation. Direct employment creation is a preferable macro-social policy response to the Troika's blind faith in the hypothetical employment effect of labour market flexibility and the gradual abolition of the minimum wage. This policy response can be promptly promoted in the form of "Employment Guarantee Programs" (EGP), aiming at channelling resources to targeted groups, e.g. youths and women, as well as to particular regions creating jobs in care and child development activities, environmental clean-up, restoration and fire protection and social and health services, which offer higher economic multipliers than traditional infrastructure public jobs (see Antonopoulos et al. 2011). However, the financing of the EGP requires the creation of an ELR fund. Practical sources of funds are revenues from tax evasion, the utilisation of public property, a percentage of the primary surplus and Treasury's cash buffer, and EU structural funds. The scale of the EGP will depend on the size of the ELR fund.

EGPs can operate as a liquidity mechanism that will cause positive macroeconomic effects to the extent that they will create income flows and domestic demand. In this sense, EGPs can be the missing link between the country's exit from the "default trap" that will reduce the currency risk, the increase in employment that will underpin social stability and cohesion and the economy's exit from recession – creating conditions for positive and high growth rates and sustainable primary surpluses. Besides, the ratio of public debt/GDP will fall, as well as the non-performing loans of households of the unemployed, and the bankrupt firms in the banking system, increasing the country's financial stability, solvency and credibility, and decreasing its currency risk.

Apart from institutionally-determined fiscal changes with immediate expansionary results, Greece also needs a new growth model. A long-term growth policy must, as of today, strive for reforms to foster the transition to a new, export-oriented economy with higher structural competitiveness. These reforms must focus on changing the structure of production and reallocating resources towards modern industries e.g. green energy and organic agriculture, as well as to import substitution industries. Nevertheless, the most important developmental change for Greece is to change the dominant culture of entrepreneurship. The latter must pursue profits from investing in R&D, expanding production, and market shares, and export-orientated activities targeting higher scales of capital accumulation, instead of making profits through redistributive mechanisms, such as tax evasion and the absorption of EU structural resources financing conspicuous consumption.

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